



National Grain and Feed Association

Testimony
Before the
House Committee on Transportation & Infrastructure
Subcommittee on Railroads
“U.S. Rail Capacity Crunch”

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Chairman LaTourette and members of the subcommittee, thank you for the opportunity to appear before you today, I am Kendell Keith, President of the National Grain and Feed Association. The NGFA has a long history of involvement in transportation issues as they are a significant area of interest for our membership and a critical aspect to the success of the grain and feed industry.

The NGFA is comprised of 900 grain, feed, processing, exporting and other grain-related companies that operate about 6,000 facilities that handle more than 70 percent of all U.S. grains and oilseeds. The NGFA's membership encompasses all sectors of the industry, including country, terminal and export elevators; feed manufacturers; cash grain and feed merchants; end users of grain and grain products, including processors, flour millers, and livestock and poultry integrators; commodity futures brokers and commission merchants; and allied industries. The NGFA also consists of 35 affiliated state and regional grain and feed associations, as well as two international affiliated associations. The NGFA has strategic alliances with the Pet Food Institute and the Grain Elevator and Processing Society, and has a joint operating and services agreement with the North American Export Grain Association (NAEGA).

The agricultural transportation and marketing system has for many decades been one of the true strengths for U.S. agriculture and its ability to function efficiently in domestic markets and be highly competitive in global markets. For domestic markets, dependable and economical rail service has allowed livestock, processing and other users of raw agricultural products to be located in areas outside of major production areas and closer to concentrations of retail consumers. In export markets, a very efficient inland

waterways system, and network of rail lines throughout the U.S. has provided the U.S. farmer one of the most economically efficient pipelines to the global marketplace.

For a number of reasons, this U.S. transportation system is turning from a strength into a potential weakness. Because of higher fuel and energy costs, congestion on railroads and highways, a lack of investment in modernization and maintenance of the inland waterway system, the cost of moving agricultural products to markets is escalating sharply in the U.S. At the same time, some of our strongest competitors in South America and elsewhere are building infrastructure to make their transportation systems more efficient. Between 1980 – 2004 Class I miles have gone from 271,000 to 167,000, a reduction of 38 percent. At the same time carloads are up by 70 percent.

The transportation capacity crunch has affected every mode in the last few years. But while the capacity challenges for truck transportation have been growing steadily for several years, the rail capacity crunch has become most critical in the last 2-3 years.

Rail Industry Capacity

The robust economy, increasing volume of intermodal business of carriers, the hurricanes and other factors have created huge demands for rail service, thus testing the capacity of the U.S. rail system like never before. Further, the predictability of service has become a huge issue. Determining when rail equipment will arrive at origin for loading, when it will be furnished locomotive power to pull the train, and when it may reach destination have all become more uncertain. One shipper from a Midwestern state reports that it is common for 100-car shuttle trains (dedicated equipment for point to point service) to arrive, be loaded within the 15 hour requirement, only to have the train sit for 5 days to be picked up. These factors combine to make the real cost of freight to rail customers even more expensive, and undermines the efficient marketing of grains and oilseeds.

Throughout the 1980s and 1990s the agricultural industry often confronted seasonal capacity shortages of transportation services when harvest pressures forced high volumes of grain into markets. Our industry learned how to deal with such seasonal shortages, but the capacity crunch we face today is chronic, and apparently much more challenging to address. Railroads are losing market share in many agricultural and food-related markets because they have proven less reliable and less predictable in service levels.

In today's rail market shippers now have to supply 54 percent of all freight cars and 100 percent of all tank cars. Unfortunately, just adding cars to the existing rail system will not solve the capacity problem. In some cases, adding more engines and more crews could make the existing systems more fluid and improve cycle times. Some of the railroads are trying to hire more people, but low unemployment in the general economy makes it a difficult environment for hiring new personnel for jobs that require considerable time away from home.

But beyond new engines and more crews to run rail equipment, railroads need to build double track in some areas, build passing lanes, and make structural changes to some key

rail yards to make them more efficient. Those kinds of investments and construction projects will take years, and if overall rail business continues to expand at its present rate, rail capacity problems may get worse, possibly for several years, before service begins to improve.

Will Railroads Invest the Necessary Capital to Solve Capacity Issues For All Customers?

The tight supply of transportation freight has led to more pricing power by rail carriers and rail profitability is generally healthy. The AAR has announced that the Class I carriers will invest more than \$8 billion in 2006 in track, cars, locomotives and other enhancements. While this investment is high by historical standards---it compares to an average investment of about \$6 billion per year in the last decade---how much additional transport capacity does it really buy? As a sizable portion of the capital expenditures of railroads goes toward replacing equipment and repair work, the capacity impact of such investments are difficult to measure.

Railroad stock analyst Anthony Hatch has observed that the “old” investment model for railroads was disinvestments: eliminating redundant track, selling lines, reducing excess car supplies. But the “new” model for rail industry investment---during a capacity shortage---is “yet to be determined”, and by no means a certainty that railroads will make the investments that rail customers would like to see for service improvements.

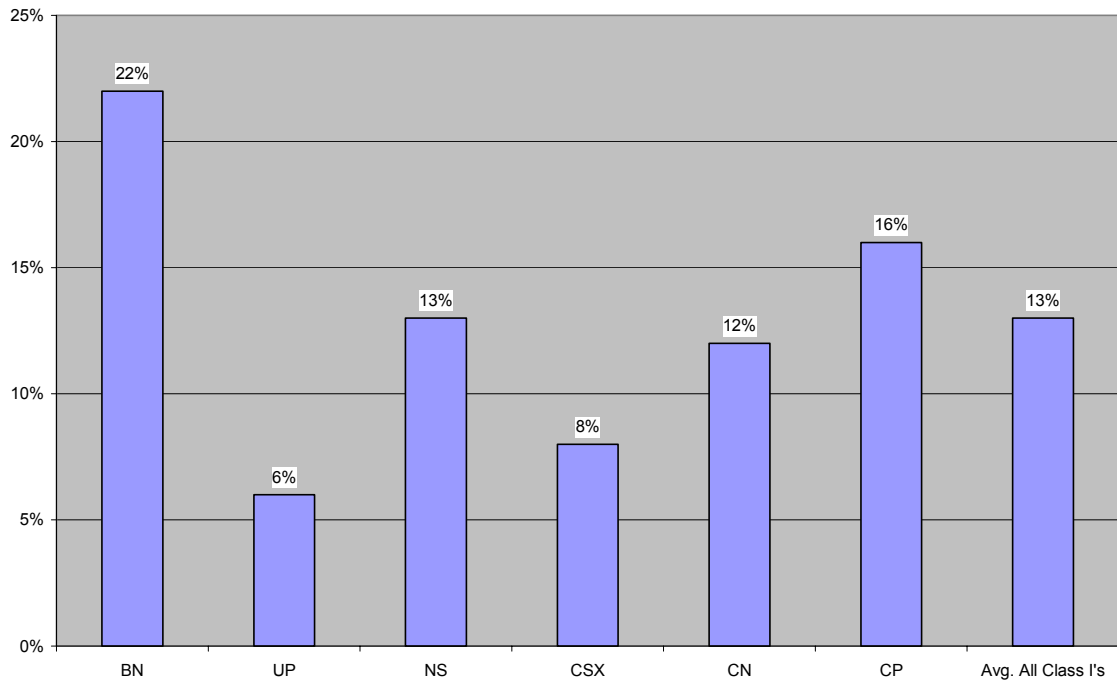
For railroads, in the past there has been a clear trade-off between expanded capacity to serve customers and Wall Street analysts assessment of stock prices. STB Vice Chairman Francis Mulvey has correctly noted that railroads have been “punished” in the past by Wall Street for making capital investments that were viewed as building new infrastructure that was “long-lived” while demand increases might be short-lived. Will Wall Street continue to play a constrictive role in railroad capital investments, or will that mindset change, given what appears to be a long-term secular rise in demand for rail freight? In our view the market fundamentals have shifted, offering much greater promise for continued growth in freight business, provided investments are made to meet demand.

How railroads have responded to heavy demand for services in the past 3 years?

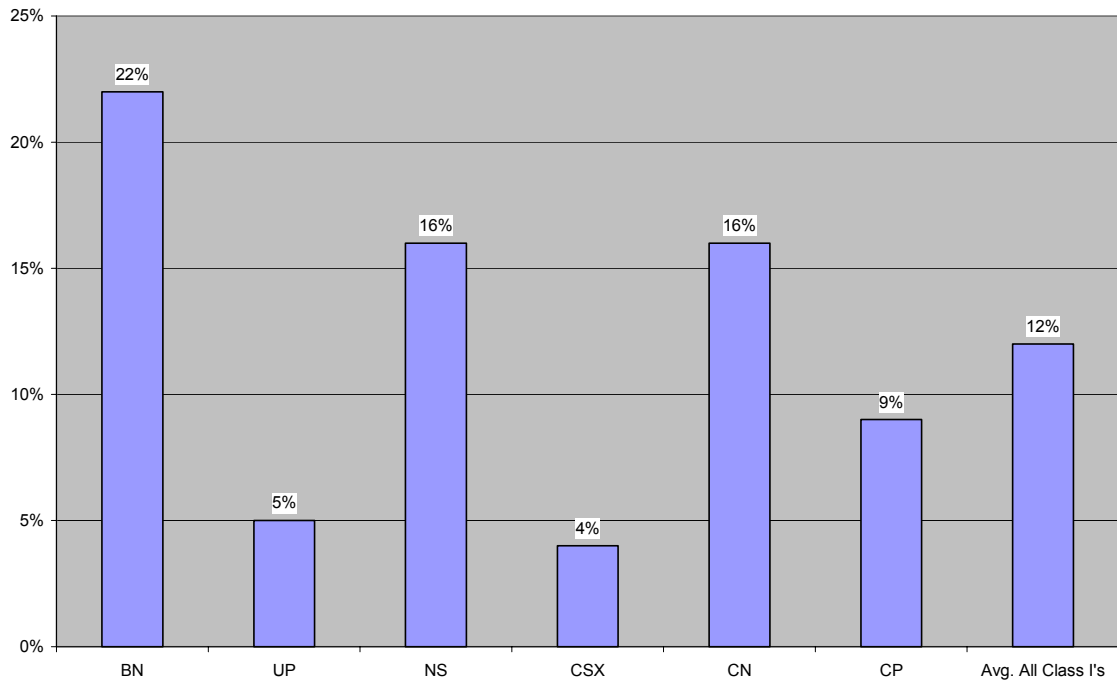
In the last few years, the intermodal business of the carriers has grown quite rapidly, along with steady growth in coal and other industries. Intermodal business is projected to reach \$8.8 billion in total rail revenues in 2006, a record pace that would give intermodal business the highest sector market share in the rail transportation sector.

Clearly, the railroads have had more business in the last few years that they could handle, as there have been many situations where the carriers have either refused new business or asked existing customers to accept a reduced level of service. How have the railroads responded to this expanded demand for rail service? The charts on the next page reflect gains by the carriers in “Revenue-Ton-Miles” and “Carloads” hauled over the last 3 years.

Revenue-Ton-Miles: Percent Change for Three Years, 2002-2005



Rail Carloads: Percent Change for Three Years, 2002-2005



These charts reflect that the ability of the carriers to respond to increase demand has varied across a wide range. Across the rail industry, revenue ton miles carried by the 6 major Class I carriers grew by 13% in 3 years, while carloads grew by 12%. The highest service growth has come from the BNSF that reports business volumes up 22% in the last 3 years. Other railroads that have met the industry average growth or better include the Norfolk Southern, Canadian National and Canadian Pacific. The Union Pacific and CSX reported the lowest business growth rates---substantially below the industry average.

What does this recent performance of railroads portend about future service levels? Certainly additional investments should enhance railroads' ability to respond to expanded demands for transportation, but the market and the rail customer need performance to improve quickly.

How will the agricultural and food industries fare in the competition for rail service?

As railroads ration their capacity to serve customers, there is concern among agricultural and food industry rail customers about how attractive our sectors are to the rail industry for service. How well do we compete for rail service with other sectors of the economy? While railroads continue to have a common carrier obligation under the law, the traditional meaning of that obligation---reasonable service on reasonable request---seems to be redefined each year as rail service capacity becomes more limited. The fastest growing segment of rail traffic is intermodal, and it receives by far the best rail service. Train speeds for intermodal traffic exceed train speeds on other railroad traffic by as much as 50%.

While many rail-served industries are receiving declining service from railroads, grain shippers are probably among the most affected because grain and grain products have not proven to be a high priority for service. Coal is getting a high priority today partly because of the temporary energy shortage. Intermodal freight is receiving priority treatment, because if railroads don't provide reasonably predictable service to that sector, they will lose the business, and it is a part of their business viewed as having significant growth potential.

Among grain shippers, shuttle train shippers (dedicated rail equipment cycling between shipping and receiving points) may continue to receive a higher priority because more grain can be moved efficiently with that class of rail service. But the problem is that not all grain and grain products can be moved by shuttle shipments because either the business volumes will not justify it or the shipping and receiving infrastructure is not sized to handle shuttles, and in many cases this "sizing" problem is not correctable even with new investments. Given the statutory common-carrier obligation for railroads, the NGFA has urged the carriers to continue to serve all types of agricultural shippers, providing reasonable service on reasonable request. In this regard, we believe it is important that the federal Surface Transportation Board provide more balanced regulatory oversight of the rail industry in the future by providing rail customers with balanced, transparent and cost-effective recourse to challenge unreasonable rail practices.

But even then, there will be some economic pain in a market that is short of capacity. Over a period of years, if the carriers invest in infrastructure, some of this capacity challenge can be resolved. But because of the growth in other types of rail business, some types of grain and grain product shippers may face a chronic struggle to obtain predictable rail service.

Solving Rail Capacity Issues

Infrastructure investments need to be made in the rail industry, and in our opinion, they need to be made sooner rather than later. Limited transportation capacity has the potential to constrain growth in the general economy, so improving transport capacity should be a national priority that deserves urgent attention. Are there other ways that railroads and their customers could work together to enhance rail performance and service? We think there are:

- The only way that some rail customers can receive service is by investing in privately owned or privately leased cars. However, railroads create additional risks and costs for private car owners through their policies and changes in policies, which cause disincentives for wise investment decisions. Railroads need to have fair and balanced policies so as to not distort market signals for investments by customers.
- The Canadian National Railway has reported success in improving train velocity and cycle times through a number of operational measures. One of these is a system of performance incentives and penalties for both the railroad and the customer. Wider adoption of more balanced incentive/penalty programs in the rail industry might provide greater incentives for both railroads and customers to meet expectations, which could enhance performance.
- Some railroad policies such as the ways some fuel surcharges are being applied, and the expansion of so-called accessorial charges, have become a major irritant for rail customers and very possibly a distraction in the effort to achieve the highest performance in rail operations. Accessorial charges have become so numerous that they are causing billing mistakes that rail customers have to spend enormous amounts of manpower to correct. The fuel surcharge issue has gotten to the point that the Surface Transportation Board will hold a hearing in early May. Some railroads' fuel surcharges are so extreme that they are earning more in such surcharge revenue than they are spending on fuel on the average shipment. More reasonable and fair policies implemented by railroads would eliminate some distractions toward achieving greater focus on solving the much more important issues of the day, such as overall rail capacity.

Conclusion

It certainly appears that the era of cheap fuel is behind us, and that only reaffirms the fact that the U.S. needs to get serious about modernizing and expanding U.S. transportation capacity. High volume, high fuel-efficiency modes such as inland waterway transportation and rail transportation should have an increasing advantage in a world of more expensive fuel, but both of these modes need new investment in infrastructure to

reap the rewards of new business that the marketplace will afford. Agriculture is highly dependent on transportation, because points of production and consumption often are separated by long distances. We need cost-effective, but also highly dependable and responsive transportation services to respond to customers' needs when they want to make purchases. We must be able to reliably supply domestic and international customers, livestock operations, grain processors and other users on the west and east coasts with grain and oilseed supplies from the Midwest. For too long, the United States probably has taken an efficient transportation system for granted. The difficulties we have confronted over the past year certainly affirm that now is the time to reassess our strategy for transportation investments going forward.

The NGFA appreciates this opportunity to share our views, and I would be pleased to respond to any questions you may have.